76-SBE-021

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
ESTATE OF WILLIAM S. HATCH,)
DECEASED, LLOYDS BANK)
CALIFORNIA, EXECUTOR,)
AND ELIZABETH HATCH)

For Appellants: Robert F. Hendrickson
Vice President and Trust Officer
Lloyds Bank California

For Respondent: Bruce W. Walker
Chief Counsel

Richard A. Watson
Counsel

OPINION

These appeals are made pursuant to section 18594 of Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of the Estate of William S. Hatch, Deceased, Lloyds Bank California, Executor, against a proposed assessment of additional personal income tax in the amount of $1, 189. 36 for the year 1968, and from the action of the Franchise Tax Board on the protest of Elizabeth Hatch against a proposed assessment of additional. personal income tax in the amount of $1, 739. 19 for the year 1968.

Two issues are presented: First, whether the basis of a decedent spouse's share of community real property sold after his death is its fair market value as of the date of death, where the deed to the property was placed in escrow pursuant to a sales agreement and the escrow conditions were substantially completed prior to death; and second, whether, under those circumstances, the surviving spouse's share of the property is entitled to a date-of-death basis.

In 1930 Elizabeth Hatch and her husband William purchased a citrus grove in Orange County, California. Although they took title to the property as joint tenants, they apparently agreed between themselves to hold it as community property. Subsequently, the Hatches transferred a one-half interest in the grove to a trust company in trust for Elizabeth and their six children.

On July 27, 1967, the Hatches, the trustee in the above mentioned trust, and a corporation entered into an escrow agreement for 'the sale of the citrus grove to the corporation. The total purchase price was to be $200, 000, divided equally between the Hatches and the trustee. The sale was conditioned on having the property rezoned for residential use. Pursuant to the agreement the deed to the property was placed in escrow, and the corporation deposited $10,000 in escrow as a down payment. After the property had been rezoned, on September 13, 1967, the corporation paid an additional $48, 000 into escrow. At this point all that remained to consummate the sale was for the buyer to pay the balance of the purchase price. On December 20, 1967, William Hatch died. Thereafter, sometime in early January of the following year, the corporation completed payment of the purchase price and received the deed to the citrus grove.

William had died testate, and his will purported to dispose of both his and Elizabeth's shares of their community property. Except for some minor specific bequests, the will placed all the spouses' community property into two trusts. Elizabeth was given a life estate with a general power of appointment in one trust, and a life estate with a remainder to the spouses' children in the other trust. Elizabeth elected to take under her husband's will. The report of the inheritance tax appraiser reveals that the clear market value of the entire estate, apparently including the proceeds from the sale of the citrus grove, was $261,454.69, and that the total value of the transfers made to Elizabeth was $ J 30,589. 29. Because of various provisions of the California Inheritance Tax Law, no inheritance tax was due on the transfers made to Elizabeth.

Elizabeth filed a joint California personal income tax return with her deceased husband for the year 1967. The proceeds from the sale of the spouses' portion of the citrus grove were reported thereon in the following manner:

> Community property having a basis of $10,881.63 was sold after the death of William S. Hatch for $100,000.00. This property was community property held in joint tenancy.. .. Both halves of the community property get a stepped up basis. Therefore no gain or loss on sale.

Respondent determined that the sale had occurred upon the closing of escrow in 1968, rather than 1967, and this conclusion is not at issue on appeal. Respondent also determined that neither spouse's, share of the citrus grove qualified for a stepped-up basis, and that Elizabeth and her husband's estate had therefore each reaiized a gain on the sale.

The pertinent statutory provisions are set out in Revenue and Taxation Code sections 18042 through 18046. Section 18042 states the general rule that the basis of property is its cost. Section 18044 provides for an exception to this rule in the case of property acquired from a decedent:

> Except as otherwise provided in this article, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the time of its acquisition.

Under section 1.8045, as it read during the year in question, the following classes of property, among others, are considered to have been acquired from a decedent for purposes of section 18044:

> (a) Property acquired... by the decedent's estate from the decedent;
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> * * *
>
> (e) In the case of decedents dying after April 8, 1953, property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any state, territory, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includable in determining the value of the decedent's gross estate under Chapter 3 of the California Inheritance Tax Law. 1/

The scope of this exception to the general rule is limited by section 18046, however, which provides that "Sections 18044 and 18045 shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under Sections 17831 to 17837, inclusive."

1/ Section 18045 has recently been amended, and the former subdivision (e) has been relettered subdivision (f). (Stats. 1975, ch. 942, p. ____.)

We first discuss the basis of William's share of the citrus grove. Since the sale was not complete until after William's death, the grove would appear to be "property acquired from a decedent" within the meaning of sections.18044 and 18045. Respondent argues that the property does not qualify for a new basis, however, because of the limitation in section 18046. It argues that the proceeds from the sale of the citrus grove constitute income in respect of a decedent, so that sections 18044 and 18045 do not apply. For the reasons expressed below, we agree with respondent.

Sections 1783 1 through 17837 of the Revenue and Taxation Code deal with "income in respect of a decedent. " While that term is not defined in the statutes, the regulations issued thereunder contain the following explanation:

> In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year. ... (Cal. Admin. Code, tit. 18, reg. 17831-17834(a), subd. (2).)

The precise question presented, therefore, is whether William was "entitled to" the proceeds from the sale of his share of the citrus grove at the time of his death. (Appeal of Estate of Henry B. Jameson, etc. , Cal. St. Bd. of Equal. , April 10, 1972.)

In pertinent part, sections 18046 and 17831 - 17837, as well as the regulations issued thereunder, are substantially identical to their federal counterparts. (Int. Rev. Code of 1954, §§1014(c), 691; Treas. Reg. § 1.691(a)-1 et seq.) Decisions of the federal courts are entitled to great weight in applying a state statute which is based on a federal statute. (Meanley v. McColgan, 49 Cal.App. 2d 203, 209 [121 P. 2d 45].) Accordingly, it is proper to consider the relevant federal case law in construing the term "income in respect of a decedent. " (Appeal of Estate of Henry B. Jameson, etc. , supra.)

In Trust Company of Georgia v. Ross, 262 F. Supp. 900, affirmed per curiam, 392 F. 2d 694, certiorari denied, 393 U. S. 830 [21 L. Ed. 2d 101], the decedent had entered into a written contract to sell his controlling interest in a hotel chain. At the time of his death, the decedent's stock in the hotel chain had already been placed in escrow awaiting final payment of the purchase price, but some of the express conditions of the sale contract had not yet been fulfilled. After the decedent's death, the executor of his estate negotiated an amendment to the sale contract concerning the manner of payment and affected the formal closing of escrow. Although the sale had not been completed until after the decedent's death, the District Court held that the proceeds of the sale were-income in respect of a decedent. The Court of Appeals affirmed on the ground that the decedent had been "entitled to" the proceeds of the sale at-the time of his death. (392 F. 2d at 696; accord, Keck v. Commissioner, 415 F. 2d 531; see also Stephen H. Dorsey, 49 T. C. 606; Appeal of Estate of Henry B. Jameson, etc., supra.)

Under the rationale of Trust Company of Georgia, at the time of his death William was clearly "entitled to" the proceeds of the sale in question here. William had entered into a binding agreement to sell his share of the citrus grove, and the deed to the property had been placed in escrow. All the escrow conditions were completed before his death, except final payment of the purchase price. No acts other than formal closing of escrow remained for the executor to perform. In sum, William had a valuable right to the proceeds of the sale, which the estate acquired solely because of his death. The proceeds therefore constitute income in respect of a decedent, and section 18044 does not apply to grant William's share of the citrus 'grove a new basis as of the date of his death. (Rev. & Tax. Code, § 18046.)

We turn now to the basis of Elizabeth's share of the citrus grove. The parties have addressed their arguments on this point to the question of whether Elizabeth's share may properly be considered "property acquired from a decedent" under former subdivision (e) of Revenue and Taxation Code section 18045, quoted above. Respondent contends that it may not, because allegedly less than one-half of the spouse's interest in the citrus grove was includible in determining the value of William's gross estate under chapter 3 of the California Inheritance Tax Law. (See Appeal of Estate of Philip Rosenberg, etc., Cal. St. Bd. of Equal., Aug. 19, 1975, modified, Feb. 2, 1976.) Elizabeth replies that more than one-half of the property must have been so includible, because the value of the tax-exempt transfers to Elizabeth amounted to less than one-half the clear market value of William's estate. We need not decide this issue, however. Under our view of the case, even assuming that Elizabeth's share of the citrus grove comes within the definition of "property acquired from a decedent" under former subdivision (e) of section 18045, it still does not qualify for a new basis.

As discussed above, Revenue and Taxation Code section 18046 renders sections 18044 and 18045 inapplicable to property which constitutes a right to receive income in respect of a decedent. Section 18046 is substantially identical to section 1014(c) of the Internal Revenue Code of 1954. The federal cases interpreting that section hold uniformly that where a decedent spouse's share of the community property constitutes a right to receive income in respect of a decedent, section 1014(c) precludes both the decedent's and the surviving spouse's shares of the property from receiving a new basis. (Bessie Stanley, 40 T. C. 851, aff'd, 338 F.2d 434; Bath v. United States, 211 F. Supp. 368, aff'd per curiam, 323 F. 2d 980 Johnson, Sr., v. United States, 14 Am. Fed. Tax R. 2d 5365; see also Wilgingg v. United States, 474 F. 2d 12.) Although those cases deal with installment sales contracts rather than a right to receive a lump sum payment, we see no reason to reach a different result under the facts of this case, Accordingly, since William's share of the community property in question constitutes a right to receive income in respect of a decedent, Elizabeth's share of that property does not qualify for a new basis. (Rev. & Tax. Code, § 18046.)

For the foregoing reasons, we sustain respondent's action.

ORDER

Pursuant to the views expressed in the opinion of the board on file in these proceedings, and good cause appearing therefor, Appeals of Estate of William S. Hatch, et al.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of the Estate of William S. Hatch, Deceased, Lloyds Bank California, Executor, against a proposed assessment of additional personal income tax in the amount of $1,189.36, and the action of the Franchise Tax Board on the protest of Elizabeth Hatch against a proposed assessment of additional personal income tax in the amount of $1,739.19 for the year 1968, be and the same are hereby sustained.

Done at Sacramento, California, this 8th day of **March,** 1.976, by the State Board of Equalization.

William M. Bennett, Chairman

Richard Nevins, Member

George R. Reilly, Member

________________ Member

________________ Member

ATTEST: W. W. Dunlop, Executive Secretary